EXHIBIT 4

NETWORK ENGINES INC (NENG)

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10–K

FORM 10–K
Filed on 12/23/2003 – Period: 09/30/2003
File Number 000–30863

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FORM 10-K

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
    SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2003

OR

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE   SECURITIES EXCHANGE
    ACT OF 1934

For the transition period from   to

Commission file number: 0-30863

NETWORK ENGINES, INC.

(Exact name of registrant as specified in its charter)

Delaware	04-3064173
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
25 Dan Road, Canton, MA	02021
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (781) 332-1000

Securities registered pursuant to Section 12 (b) of the Act: None

Securities registered pursuant to Section 12 (g) of the Act: Common Stock,
$0.01 par value

Indicate by check mark whether the registrant: (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period than the
Registrant was required to file such reports), and (2) has been subject to such

filing requirements for the past 90 days.   Yes [X] No [_]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statement incorporated by reference in part III of this Form 10-K or any amendment to this Form 10-K. [   ]

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).   Yes [X] No [   ]

The aggregate market value of the voting Common Stock held by non-affiliates of the registrant on December 12, 2003 was approximately $155,424,351.

The number of shares outstanding of the registrant's Common Stock as of December 12, 2003: 35,929,531 shares.

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NETWORK ENGINES, INC.

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended September 30, 2003

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PART I

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This Form 10-K contains forward-looking statements within the meaning of Section
21E of the Securities Exchange Act of 1934, as amended, that involve risks and
uncertainties. All statements other than statements of historical information
provided herein are forward-looking statements and may contain projections
relating to financial results, economic conditions, trends and known
uncertainties. Our actual results could differ materially from those discussed
in the forward-looking statements as a result of a number of factors, including
the factors discussed in this section and elsewhere in this report and the risks
discussed in our other filings with the Securities and Exchange Commission.
Readers are cautioned not to place undue reliance on these forward-looking
statements, which reflect management's analysis, judgment, belief or expectation
only as of the date hereof. We undertake no obligation to publicly reissue these
forward-looking statements to reflect events or circumstances that arise after
the date hereof.

                                    PART I

ITEM 1.BUSINESS

Overview

Network Engines develops, manufactures and distributes server appliance
solutions that enable network equipment providers and independent software
vendors, or ISVs, to deliver data storage and security networking applications
to their customers. We also distribute third party storage networking
connectivity products for the leading Fibre Channel host bus adapter, or HBA,
and storage switch manufacturers in the data storage industry to our customer
base of over 400 value-added resellers, or VARs, and systems integrators. We
believe we are a leading provider of server appliance solutions and distribution
services by virtue of our ability to offer a complete range of supply-chain
services to network equipment providers and ISVs.

We are currently organized into two reportable segments: OEM Appliance and
Distribution. Our OEM Appliance operation leverages our server appliance
development, manufacturing and logistics services. We produce and fulfill
devices branded for our network equipment and ISV partners, and we derive our
revenues from the sale of the value-added hardware platform to these partners.
These partners subsequently sell and support the device under their own brands

to their customer base. Revenues from our Distribution operations are derived from two activities; first is the revenue derived from the distribution of third party products and components, primarily related to data storage area networking; second is the distribution of server appliances that we develop, manufacture, sell and support on behalf of our ISV partners.

Server appliances are pre-configured network infrastructure devices designed to optimally deliver specific software application functionality and facilitate ease of deployment and support of a software application in a customer's network. We offer our server appliance customers a comprehensive suite of services, including development, manufacturing, fulfillment, distribution and post-sale support. Our server appliances are sold and supported either by the application provider or alternatively by us through our recently-acquired Distribution operation. Our OEM Appliance customers include: Borderware, Inc., EMC Corporation, Ipsum Networks Inc., Network Intelligence Corporation, Silent Runner (recently acquired by Computer Associates), Sonexis, Inc. and Tumbleweed Communications

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Corporation and our Distribution customers include: CDW Corporation, Forsythe Solutions, Inc., Tech Data Corporation and Electronic Data Systems Corporation. Sales of server appliances to EMC represented 47% of our total net revenues in fiscal 2003 and 83% of our total net revenues in fiscal 2002.

In December 2002, we acquired all of the capital stock of TidalWire Inc., a privately held corporation dedicated to the distribution and support of data storage networking products, for total consideration of $17.5 million. This acquisition provided us with a Distribution operation focused on data storage networking connectivity products, primarily Fibre Channel HBAs, serving an extensive customer base, including many of the leading VARs and systems integrators in North America. TidalWire is one of two authorized distributors in North America for Fibre Channel HBAs that have been tested and approved by EMC. Sales of Fibre Channel HBAs tested and approved by EMC accounted for 33% of our total net revenues in fiscal 2003. In the most recent fiscal year, TidalWire distributed products from leading storage networking vendors, including Brocade Communications Systems, Inc., Emulex Corporation, JNI Corporation, McData Corporation and Qlogic Corporation to over 400 VARs and systems integrators, which in turn sold these products to a large base of enterprise customers. TidalWire also provided us with a sophisticated customer relationship management, or CRM, system, a customer internet portal and expanded post-sales support capabilities. We have begun to leverage our acquisition of TidalWire to offer these distribution capabilities to our current and future application provider partners, enabling us to expand our server appliance business.

Headquartered in Canton, Massachusetts, Network Engines began developing custom server hardware platforms in 1997 for internet-based organizations, content infrastructure providers and larger enterprises. In 1999, we achieved an important milestone by introducing a one-rack unit Intel-based server, representing a server only 1.75 inches in height. At that time, we designed most of the hardware components that went into our servers and, as a result, we invested significant resources in the development of our products. Subsequently, a significant number of companies entered the one rack unit server marketplace, much of the hardware components of server appliances became commoditized and, at the same time, the demand of internet-based organizations declined precipitously. As a result, we restructured our operations in fiscal 2001, which

among other things de-emphasized the use of proprietary components in server hardware platforms. Our purchase of TidalWire in December 2002 has enhanced our supply chain capabilities. Today, we combine our hardware packaging, system design and software integration expertise with our manufacturing, distribution, logistics and post-sales support capabilities to provide a complete solution for our application provider customers.

Industry Background

Traditionally, networking solutions were built utilizing custom-designed hardware and proprietary operating systems. Vendors developed custom components and systems in an effort to meet the high performance demands of their customers, such as increasing networking speeds, packet processing requirements and internal storage capabilities. Standard components that could meet these performance demands were not commercially available, requiring networking equipment companies to invest considerable capital in hardware and system-level research and development. While these highly integrated systems were designed to address the performance demands of the customer, they were expensive due to the cost of research and development related to the requisite customization.

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Networking solution vendors generally maintained internal research, development, manufacturing and integration expertise in both hardware and software, as both were critical aspects of a networking solution and viewed as essential to maintaining a competitive advantage.

Over time, much of the networking solutions market has evolved toward the development and manufacture of systems, which are built using commercially available standardized components and standardized operating software platforms. Networking solutions vendors are driven by continuous market demand for lower priced systems and a desire to utilize ubiquitous processing and operating system platforms, which promote standard- based solutions. The speed and processing power of standard Intel-based processors has reached a level where these processors can adequately meet the demands of many networking applications. Operating system platforms, such as Microsoft and Linux, have also increased in power and sophistication and can now be used as the 'embedded' operating system environment for today's networking applications.

This evolution in the development and manufacturing of systems built with commercially-available, standardized components has allowed networking equipment vendors to refocus development efforts and resources toward the application software and system integration aspects of their solutions. Vendors recognize that custom hardware development in many cases is no longer critical in meeting their customers' performance requirements. Competing systems are being integrated and packaged on standardized hardware platforms and, therefore, hardware alone no longer differentiates a system in the marketplace. As a result, network equipment providers have begun outsourcing components of hardware integration, test, manufacturing and logistics to partners that specialize in these skills.

The ability of standard server hardware and operating systems to meet the demands of networking applications served as a catalyst in the emergence of an ISV industry focused on delivering enterprise class networking application software. However, these servers often require hardware customization and software "tuning" to optimize the performance of the application. Manufacturers

of general-purpose servers, such as Dell Corporation, IBM Corporation and Hewlett-Packard Co., generally do not provide specific customization of their products for most networking application vendors. ISVs using general purpose servers must invest considerable development resources in order to facilitate the deployability of their applications across multiple general-purpose servers and operating system environments, and must also invest in the post-sales support of the application in varied deployment scenarios and changing network environments. In addition, the deployment of some application software on general-purpose servers and operating system environments is not ideal for the end-user customer due to the time and cost of implementation, the expertise required to optimize performance and challenges relating to on-going support and migration. The server appliance market has recently developed in response to these shortcomings and to reduce the total cost of ownership to the end-user customer. Server appliances are pre-configured network infrastructure devices designed to optimally deliver specific software application functionality and facilitate ease of deployment and support of a software application in a customer's network.

While there are many applications for which a server appliance may ultimately be used, early adoption of the technology is most prevalent in the data storage and security networking markets. These markets are significant in size and have exhibited robust growth in recent years. The security

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applications that we believe are most likely to benefit from a server appliance solution include anti-virus, content filtering, content security, firewalls, authentication, intrusion detection and prevention, device relationship management, digital rights management, web services management and instant messaging, or IM, security. The storage applications that we believe are most likely to benefit from deployment in the form of a server appliance include storage security, backup and recovery, virtual tape libraries, business continuance, storage resource management and storage virtualization.

Another significant trend driving the growth of the data storage and security markets is the decentralization of storage management applications and security applications. Enterprises are deploying applications both in data centers and in department or remote offices. As a result, there is an increased need for applications that can be deployed quickly and efficiently without the need for extensive internal IT resources. Furthermore, remote monitoring and upgrades have become a critical aspect of managing the network of an enterprise.

Finally, the small to medium size enterprise market has grown extensively and requires sophisticated networks with integrated storage and security functionality. Given the limited resources of these smaller businesses, we believe network equipment providers and ISVs must provide turnkey solutions that are easy to install and deploy and require minimal human maintenance and management resources.

We believe that the following capabilities are necessary to best serve the needs of network equipment providers and ISVs seeking to deploy server appliance based solutions to their enterprise customers:

Depth of understanding of server appliance development.   A server appliance partner should not only be familiar with the generally available standard components and general purpose servers, but they should be capable of

integrating the hardware, operating systems, utilities and application software in a low-cost, optimized solution. The server appliance partner should also be able to offer custom hardware development expertise in the event that the requirements of the network equipment or ISV partner are not satisfied by leveraging standard commercially available server platform technology.

Understanding of distribution channels, logistics and post-sales support.   The server appliance partner should be capable of assisting their ISV partners with distribution, fulfillment and support of their product in the field, as many of these partners generally will not maintain internal hardware support staff to address a hardware or technical problem with the server appliance solution.

Access to flexible and high-quality manufacturing facilities.   Network equipment providers and ISVs should be confident that a server appliance partner has comprehensive manufacturing capabilities and appropriate product testing and quality measures. The quality of the overall solution is dependent upon a well manufactured and integrated product.

Hardware and software platform design skills.   In addition to server appliance development skills, a server appliance partner needs to be capable of tuning the performance of a server appliance system to meet the performance demands of the application. This requires access to, and understanding of, tools and utilities which can be integrated into the system to optimize its performance. This design skill set requires significant software, hardware and networking expertise.

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Ability to address rapid technological change.   The data storage and security networking markets are dynamic and subject to rapid change. Furthermore, the commercially-available, standard component market is constantly evolving as new generations of central processors, network processors and operating systems are frequently introduced to the marketplace. A server appliance partner should understand these changing environments and be able to evolve an existing solution to deliver the same or better level of functionality and avoid technical performance issues.

Network Engines' Solution

We develop, manufacture and distribute optimized server appliance solutions that enable our network equipment and ISV partners to deliver data storage and security networking applications to their customers. We focus on developing cost-effective server appliance solutions to meet the performance requirements of our partners' software applications in order to address the deployment and cost of ownership needs of their end customers. We are a leading distributor of data storage networking equipment, primarily Fibre Channel HBAs, to VARs and systems integrators in North America. We have begun to leverage our distribution capabilities for our server appliance partners. Key elements of our solution include:

Appliance development expertise.   One of our two core businesses is developing and manufacturing high quality server appliance solutions in conjunction with our network equipment and ISV partners. We have developed a step-by-step appliance development process which takes into account all aspects of the products' design, from performance requirements to branding, packaging and quality assurance. We engage with our partners at multiple levels of their organization, including engineering and product management, to optimize the

product or suite of products by focusing on the integration of the hardware, operating system, utilities and application software. We make use of in-house server platform designs complemented by third-party server platforms, depending on the configuration and application requirements.

Comprehensive distribution and support capabilities.   We believe our distribution capabilities, our second core business, are a critical part of our operations that have provided us with end-to-end supply chain capabilities, broad knowledge of the data storage market and a growing third party storage networking equipment Distribution business. We believe the breadth of our distribution capabilities is an important differentiating factor for our storage networking vendor and server appliance distribution ISV partners. For these partners, we have begun to act as a value-added distributor, selling the ISV's software in the form of a co-branded server appliance and acting as the point of sale and support for the device, allowing these ISV partners to maintain a software-only business model. We take responsibility for developing, manufacturing, sales, logistics and around-the-clock first level post-sales support of the finished product.

Flexible, high-quality manufacturing services.   We have a sophisticated manufacturing facility at our headquarters in Canton, Massachusetts, which is ISO 9001:2000 certified. Our advanced control processes and systems, and comprehensive system tests that we develop with our partners, are designed to ensure quality and trace-ability at every step of the manufacturing process. We believe one of our core strengths is our flexibility and ability to react quickly to accommodate changes in customer demands, including increasing order volumes, engineering changes to existing products and new

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product introductions. For certain high-volume products, we supplement our production capacity and make provision to maintain continuity of supply, through a relationship with a contract manufacturer.

Custom design services.   We believe our expertise in developing customized hardware platforms is a significant competitive advantage with respect to partners for whom commercially available platforms are not an appropriate solution. This capability is based on our heritage of designing and optimizing custom server platforms, and is generally driven by our customers' requirements for density, performance or cost optimization. Our customization skills include hardware, firmware and software integration and packaging. Our team of skilled engineers and third party contractors has significant industry experience in high-density packaging, server design, testing, quality assurance and technical documentation.

Appliance life cycle management.   We operate in a technology environment in which platforms, operating systems, components and software applications are constantly evolving. We pro-actively analyze these developments in order to maintain the operation of our partners' software applications despite changes in the underlying technologies. We also adapt the appliance solutions to meet emerging requirements and capabilities of new versions of our partners' software applications. We believe our expertise in life cycle management has become a critical factor in attracting new partners and retaining our existing partners.

Business Strategy

Our objective is to become the leading global provider of server appliance solutions and distribution services for the data storage and network security markets. The key elements of our strategy include:

Broaden our relationships with network equipment and ISV partners to sell server appliance solutions.   We believe that our full service supply chain capabilities are a competitive advantage in the marketplace today. We intend to leverage this advantage to develop additional business within our existing customer base and identify and attract new partners. We are targeting quality partners in the data storage and network security markets where initial adoption of the server appliance solution has been most prevalent. We believe our ability to sell server appliance solutions to our customer base of over 400 VARs and systems integrators represents an important channel opportunity for our server appliance distribution ISV partners.

Expand our relationships with VARs and systems integrators.   Our acquisition of TidalWire provided an established business focused on distributing third party data storage networking products to VARs and systems integrators. We intend to strengthen our distribution network by both identifying new VARs and systems integrators and expanding our existing distribution relationships. Our existing distribution network has penetrated a majority of the leading data storage VARs and systems integrators in North America. Our current focus is to leverage these relationships in order to expand into our customers' network security practice, and thereby capitalize on the trend toward convergence of network security and data storage management.

Expand the breadth and depth of our server appliance hardware offerings.   We believe that network equipment providers and ISVs will continue to have new requirements for "turn-key"

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appliance solutions and, as a result, there is a need for us to offer as wide a variety of server appliance hardware platforms as possible. Therefore, we intend to continue to expand our relationships with vendors of hardware platforms and components which provide leading edge performance or significant cost advantage. In addition to the custom design hardware platforms that we offer, we will continue to purchase commercially available hardware platforms from other manufacturers both to reduce our costs and to increase the range of our product offerings.

Establish strong brand identity of Network Engines co-branded server appliances.   One of the purposes of our TidalWire acquisition was to enable us to employ a Network Engines branding strategy for our server appliance distribution activities. This strategy is designed to establish company name recognition, product brand equity and identification in the data storage and security networking markets. Currently, we co-brand all server appliances we sell through our Distribution operations. In the future, we intend to further develop our branding strategies.

Invest in businesses, products and technologies.   We intend to continue to invest in businesses, products and technologies that will provide us with additional industry expertise, enhance our range of product offerings, expand our development and production capacity, broaden our client base and expand our geographical presence. These investments may take the form of internal development expenditures or the strategic investment in or acquisition of

businesses, products and technologies.

Products and Services

We develop, manufacture and distribute optimized server appliance solutions that enable our network equipment and ISV partners to deliver data storage and security networking applications to their customers. We also distribute storage networking equipment to VARs and systems integrators and have begun to leverage our distribution capabilities for our application partners. We have developed a comprehensive suite of products and services, enabling our network equipment and ISV partners to accelerate the time to market of a new product, to optimize their server appliance solutions and to advance the distribution of their product by leveraging our large customer base of VARs and systems integrators. Our products and services are described as follows:

Server appliance development

We have developed a structured approach to appliance development, which we refer to as the 'accelerate program'. Through our accelerate program, we break the customer engagement and ultimate delivery of the product into six stages and clearly identify the responsibilities for both the partner and for ourselves. This program is designed to ensure that the engagement with our application partner is well managed and executed and anticipates and includes all aspects of the solution requirements of the customer. The six key phases of the process consist of the following:

YDefinition: Network Engines and application partner establish project teams and develop product requirements.

YDevelopment: Engineering teams from Network Engines and application partner work together to define a prototype.

YPrototype: Engineering teams develop, build and test prototype.

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YPilot Manufacturing: Network Engines manufacturing builds the First Article unit, a representative sample of the final product.

YFirst Article: Both parties approve the final product and Network Engines finalizes manufacturing, fulfillment, and post-sale support processes.

YGeneral Availability: The final product is released to Network Engines manufacturing for production.

We have had a significant amount of experience in developing server appliance solutions and, as such, we believe that our structured approach brings benefits to our partners, improves the chances for a successful development and speeds the process of bringing a product to market by anticipating key challenges and opportunities and proactively addressing them during the engagement.

Custom server design and integration

Our design team is well versed in custom server design, generally utilizing

standard off-the-shelf components and sub-systems. Such customized hardware requires significant hardware design, packaging, regulatory and thermal profiling skills. Our embedded software design team also performs low-level hardware driver development as well as BIOS modifications and tuning. We leverage these server development skills in order to deliver custom solutions to our application partners.

Manufacturing and test services

We provide internal manufacturing, test and fulfillment services for our server appliance partners. We operate separate manufacturing lines for high volume and low volume manufacturing. Our high volume manufacturing process involves building the chassis, including the integration of the main logic board, memory, disk drive and PCI-board into the chassis and testing of the final product. Our low volume process involves branding of third-party supplied servers, as well as memory, disk drive and PCI board integration and testing. We maintain two separate lines in order to provide our partners with the appropriate type of manufacturing resources and skill sets to best meet the volume requirements of a particular product. In addition, our low volume line allows us to provide customers with rapid product manufacturing turn around time, which provides a significant time to market advantage for new products. Our partners' products undergo system test and burn-in prior to final inspection, packaging and shipment.

Branding, packaging and fulfillment services

One of the key activities we undertake is the branding of the server appliance solution for our network equipment or ISV partner. Branding is applied to the server appliance itself as well as to all accompanying documentation, including quick set-up guides, manuals, shipping cartons, shipping labels and paperwork. We retain a full time graphic artist who is responsible for production of branding designs and we work with outside design and production agencies that are highly experienced in equipment packaging and branding approaches.

We deliver the final product to either our customer or, at their request, directly to their end user customers. We also offer to distribute the final product to end users via our Distribution operations.

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Distribution operations

We acquired and continue to invest in a sophisticated infrastructure designed to maximize efficiency of the Distribution operation. Our sales team is well trained on the products we sell. We currently distribute the following third party storage networking products:

YHBAs manufactured by Emulex, Qlogic and JNI;

YStorage switches manufactured by Brocade and McData; and

YMiscellaneous storage connectivity accessories from Emerson Electric Company (dba Emerson Network Power), Atto Technology, Inc., Crossroads Systems, Inc. and CipherOptics, Inc.

In addition, we have begun to distribute the following co-branded server appliance products:

YSteel-Belted Radius
 (R)
 Appliance in conjunction with Funk Software, Inc.; and

YVirtual Tape Library, or VTL, Appliance in conjunction with FalconStor Software, Inc..

We also have a number of co-branded server appliance products in development with new partners, including:

YAuthenex, Inc.;

YBocada, Inc.;

YKVS, Inc.;

YComputer Associates International, Inc.; and

YCommVault Systems, Inc..

In addition, we provide the following distribution services to our partners:

Customer profiling

Our customer database allows us to offer our partners customer profiles by geography, skill set and vertical/horizontal market focus. As they work with us to introduce new products into our customer base, profiling allows us to identify the most appropriate match for their product offerings and improves our ability to focus sales and marketing efforts toward a specific audience.

Product catalog management

We offer our partners a web-based product catalog which allows our customers to access product data, including pricing, data sheets, technical specifications and FAQs.

e-Business portal for on-line quoting and ordering

We offer the ability to key customers to transact electronically directly with TidalWire. We establish secure, partner-specific extranet sites, which display the partner's approved pricing, ordering and quote status as well as special promotions and information on products. We consider our ability to transact electronically with our key customers a key competitive advantage.

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Distribution marketing

We undertake aggressive marketing campaigns in conjunction with our distribution partners. These include seminars over the internet, electronic news letters, trade show attendance, and targeted advertising. We also operate a customer portal at www.tidalwire.com. This is a portal for storage and security professionals, and includes industry recognized contributed writers, product feature opportunity for our distribution vendor partners and access to the TidalWire customer center for on-line quotes and ordering.

Customers and Partners

Each of our business segments, OEM Appliance and Distribution operations, targets a distinct customer base. Our OEM Appliance business targets network equipment vendors and ISVs who wish to sell server appliance solutions to their customers. During the past fiscal quarter, our OEM Appliance business sold server appliances to 10 customers, including: Borderware, EMC, Ipsum Networks, Network Intelligence, Silent Runner (recently acquired by Computer Associates), Sonexis and Tumbleweed Communications. EMC was our only customer which represented more than 10% of our revenues for the years ended September 30, 2003 and 2002, during which, sales to EMC were $38.3 million, or 47% of total net revenues and $12.1 million, or 83% of total net revenues, respectively.

The targeted customers for our Distribution business include over 400 VARs and systems integrators in North America. One of the benefits we provide to our distribution customers is access to a portfolio of leading storage networking products on the market. We purchase these products from our storage networking vendor partners, including: Brocade, Emulex, JNI, McData and Qlogic.

Historically, our TidalWire Distribution business derived substantially all of its revenue from the distribution of HBAs and other data storage networking products. We have recently begun to leverage TidalWire's distribution capabilities by partnering with ISVs and distributing co-branded server appliance solutions. Our current ISV partners include: Authenex, Bocada, CommVault, Computer Associates, FalconStor, Funk Software and KVS Inc.

Sales and Marketing

Sales

Our OEM Appliance sales team is focused on developing strategic partnerships with network equipment providers seeking to integrate a server appliance into their offerings and ISVs seeking to offer their application software as an appliance solution. Once we have identified and qualified a potential prospect and a project is identified, a regional sales manager and systems engineer meet with the customer and begin to work on an appropriate strategy. We then involve other employees from engineering and product management to analyze the prospective customer's requirements and begin to develop a solution.

Our distribution sales team is focused on two separate activities: first, identifying new ISV partners interested in utilizing our appliance distribution services and, second, selling our server appliance solutions and third party data storage networking equipment to our channel of over 400 VARs and systems integrators. Similar to our OEM appliance sales process, a regional sales manager and systems engineer engage with and qualify prospective server appliance partners and quickly involve engineering and product marketing.

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Our distribution sales team consists of territory sales managers, inside sales managers, systems engineers and business line managers. This team engages with our partners' sales team to promote and take orders for our products.

Marketing

We have aligned our marketing organization by two key functions: product management and marketing programs. Our product management team is responsible for managing the technical relationship with our hardware platform, operating systems and components suppliers. The product management team researches the market to anticipate trends and understand and evaluate new technologies that we can leverage in the development and integration of server appliance solutions. They work closely with our engineering team and our ISV partners to define product requirements. Our product management team is also responsible for pricing and promotion of co-branded ISV appliances. Our marketing program team is responsible for building market awareness and acceptance of Network Engines and our products and services and generating qualified customer leads.

Warranty and post sales support services

We offer a warranty on all of the products we sell. The warranty generally provides for us to repair or replace a defective product within certain timeframes and generally lasts for a period of up to 36 months after initial product shipment, depending on the product and our contractual relationships with certain customers.

For our OEM Appliance customers, we offer a range of post sales support services, including advanced replacement of defective units as well as repair and return service for appliance platforms covered by our contractual warranty.

Our Distribution operation provides first line technical support and manages repair and advanced replacement logistics for some third-party products under warranty. For appliance products, we provide first line technical support to the end user or reseller in order to ascertain whether the issue with the server appliance is hardware or software related. To the extent that the issue is hardware related, we endeavor to resolve the problem over the telephone, and in the event that this is not possible, we ship a replacement unit to the end user. In the event that the problem is deemed to be application software related, we escalate the call to our ISV partner. We offer round-the-clock support, and leverage a relationship with a third-party call center provider to manage our calls and trouble tickets. We believe these are valuable services and are key differentiators for our Distribution operations.

Manufacturing

We provide manufacturing, test and fulfillment services for server appliances through our 15,000 square foot manufacturing facility located at our headquarters in Canton, Massachusetts. In October 2003, we received ISO 9001:2000 certification. We operate separate server appliance manufacturing lines for high volume and low volume manufacturing. We maintain two separate lines in order to provide our partners with the appropriate type of manufacturing resources and skill sets to best meet the volume requirements of a particular product. In addition, our low volume line allows us to provide customers with rapid product manufacturing turn around time, which provides a significant time to market advantage for new products.

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We also supplement our manufacturing capacity for certain high-volume products by utilizing a third-party contract manufacturer who has multiple manufacturing locations in the United States and abroad. We use this partner to handle excess volume requirements and also as a disaster-recovery site in the event that our Canton facility is shut down for any reason. We have developed electronic system-to-system information links with this partner in order to leverage the high degree of automation we have established in our own manufacturing facility.

Logistic Services

In order to deliver distribution products in a timely and reliable manner to our customers, we leverage the global logistics capabilities of FedExTM. Substantially all distribution inventory, including server appliances we sell through distribution, are consigned to a FedEx depot. Electronic links between us and FedEx allow us to electronically send shipping instructions to FedEx, allowing same-day shipment of products from the FedEx facility Monday through Friday, subject to product availability.

Engineering

We believe that much of our future success depends on our ability to customize server appliances developed utilizing commercially available standard components and platforms acquired from third party suppliers. This customization includes both hardware and software modifications and enhancements to the standard platforms. We have assembled a team of highly skilled engineers, contractors and suppliers with significant industry experience in high-density packaging, server appliance design, system software, quality assurance, testing and technical documentation.

Employees

As of September 30, 2003, we had 97 employees, of whom 17 were engaged in manufacturing, 41 were engaged in sales and marketing, 18 were engaged in research and development and 20 were engaged in general and administrative. We also employ contract labor, predominately in our manufacturing operations. As of September 30, 2003, we also utilized 35 contract employees.

Backlog

Our backlog includes orders confirmed with a purchase order for products scheduled to be shipped within 180 days to customers with approved credit status. Certain of our OEM Appliance customers place large orders with us to be delivered over time. In addition, we have an inventory consignment agreement with our largest customer whereby shipments to this customer are held at this customer's location until this customer requires the products shipped. We do not recognize revenues from consignment shipments until the consigned product is utilized. Also, certain of our OEM Appliance customers, including our largest customer, have certain rights under our agreements with them to change the delivery timing of future shipments to them. In addition, our agreement with our largest customer includes provisions that allow this customer to cancel unfulfilled purchase orders within certain contractual time periods. As a result of these factors, we do not consider our backlog to be firm nor do we believe that our backlog, as of any particular date, is necessarily indicative of actual net sales for any future period.

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Competition

Our markets are highly competitive, and we expect this competition to persist and intensify in the future.

The principal competitors of our appliance business are general-purpose server manufacturers that provide solutions for ISVs and build servers for the OEM marketplace. These competitors include Dell, Hewlett-Packard, IBM and Sun Microsystems. We also compete with major distributor integrators such as Arrow Electronics, Inc., Agilysys, Inc. and Avnet, Inc. that offer distribution as well as customized integration services to their customers. In addition, we compete with smaller companies that specialize in building server products and providing some level of integration services.

We believe that we compete favorably on factors that are important to our target market, including customized engineering capabilities, manufacturing and design capabilities and high value added distribution and support capabilities, as well as our flexibility and responsiveness.

The principal competitors of our Distribution business are large electronic and server distribution companies, including Bell MicroProducts Inc., GE Access (a division of General Electric Company) and Tech Data Corporation. With respect to our EMC-approved host bus adapter Distribution business, we currently compete with INFO-X Inc., the only other EMC authorized distributor of such product in North America.

Intellectual Property

We have trademarks for the use of the Network Engines and TidalWire names and the Network Engines and TidalWire logos. We believe these trademarks provide us with additional protection over the use of these names and descriptions. We also enter into confidentiality or license agreements with our employees, consultants and corporate partners, and control access to and distribution of our software, documentation and other proprietary information. Subsequent to the restructuring of July 31, 2001, we reduced our dependence on intellectual property and proprietary technology. We also have four patents that primarily pertain to our historical business and will remain in effect until 2020 or later. In addition, we have several patent applications pending.

Despite our efforts to protect our proprietary rights, our competitors might independently develop similar technology and unauthorized parties may attempt to copy or otherwise obtain and use our technology. Monitoring unauthorized use of our proprietary technology is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. Due to rapid technological changes in our market, we believe the various legal protections available for our intellectual property are of limited value. In addition to such intellectual property, we seek to establish and maintain an extensive knowledge of leading technologies and to incorporate these technologies into our appliance platforms by leveraging the technological knowledge and creative skills of our personnel.

Financial Information About Geographic Areas

See Note 15 to our Consolidated Financial Statements, entitled "Segment and Geographic Data", for financial information about geographic areas. The Notes to the Company's Consolidated Financial Statements are contained herein in Item 8.

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Website Access to SEC Reports

We maintain an internet website at www.networkengines.com. Our periodic SEC reports (including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K) are accessible through our website, free of charge, as soon as reasonably practicable after these reports are filed electronically with the SEC.

ITEM 2.PROPERTIES

Our principal business operations are conducted in our corporate headquarters in Canton, Massachusetts where we lease approximately 52,000 square feet of manufacturing and office space. We believe that our Canton facility will be adequate to meet our requirements for the foreseeable future.

ITEM 3.LEGAL PROCEEDINGS

From time to time, various lawsuits, claims and proceedings have been, and may in the future be, instituted or asserted against us or our officers or directors, including those pertaining to patent infringement, securities laws, intellectual property, product liability, safety and health, employment and contractual matters. The outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to us.

Announcement Timing Lawsuit

A purported class action lawsuit was filed on December 16, 2003 in the United States District Court in the District of Massachusetts against Network Engines, John H. Curtis, its President and CEO, Douglas G. Bryant, its CFO, Vice President, Treasurer and Secretary, and Lawrence A. Genovesi, its Chairman of the Board, relating to the timing of the announcement of the amendment of its agreement with EMC Corporation regarding the resale of EMC-approved host bus adapters (HBAs). The plaintiffs in the complaint claim that Network Engines and Messrs. Curtis, Bryant and Genovesi allegedly failed to disclose that Network Engines was in the process of renegotiating its distribution contract with EMC while issuing positive statements highlighting Network Engines financial performance and related matters. The plaintiffs are seeking unspecified damages. Network Engines believes that the action is without merit, and it intends to vigorously defend against the suit.

Initial Public Offering Lawsuit

On or about December 3, 2001, a putative class action lawsuit was filed in the United States District Court for the Southern District of New York against the Company, Lawrence A. Genovesi (the Company's Chairman and former Chief Executive Officer), Douglas G. Bryant (the Company's Chief Financial Officer and Vice President of Finance and Administration), and the following underwriters of the

Company's initial public offering: FleetBoston Robertson Stephens, Inc., Credit
Suisse First Boston Corp., Goldman Sachs & Co., Lehman Brothers Inc. and Salomon
Smith Barney, Inc. (collectively, the "Underwriter Defendants"). An amended
class action complaint, captioned In re Network Engines, Inc. Initial Public
Offering Securities Litigation, 01 Civ. 10894 (SAS), was filed on April 20,
2002.

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The suit alleges that the defendants violated the federal securities laws by
issuing and selling securities pursuant to the Company's initial public offering
in July 2000 ("IPO") without disclosing to investors that the Underwriter
Defendants had solicited and received excessive and undisclosed commissions from
certain investors. The suit also alleges that the Underwriter Defendants entered
into agreements with certain customers whereby the Underwriter Defendants agreed
to allocate to those customers shares of the Company's Common Stock in the
offering, in exchange for which the customers agreed to purchase additional
shares of the Company's Common Stock in the aftermarket at pre-determined
prices. The suit alleges that such tie-in arrangements were designed to and did
maintain, distort and/or inflate the price of the Company's Common Stock in the
aftermarket. The suit further alleges that the Underwriter Defendants received
undisclosed and excessive brokerage commissions and that, as a consequence, the
Underwriter Defendants successfully increased investor interest in the
manipulated IPO securities and increased the Underwriter Defendants' individual
and collective underwritings, compensation and revenues. The suit seeks damages
and certification of a plaintiff class consisting of all persons who acquired
shares of the Company's Common Stock between July 13, 2000 and December 6, 2000.

In July 2002, the Company, Lawrence A. Genovesi and Douglas G. Bryant joined in
an omnibus motion to dismiss challenging the legal sufficiency of plaintiffs'
claims. The motion was filed on behalf of hundreds of issuer and individual
defendants named in similar lawsuits. Plaintiffs opposed the motion, and the
Court heard oral argument on the motion in November 2002. On February 19, 2003,
the Court issued an opinion and order denying the motion as to the Company. In
addition, in October 2002, Lawrence A. Genovesi and Douglas G. Bryant were
dismissed from this case without prejudice. On July 9, 2003, a Special Committee
of the Company's Board of Directors authorized the Company to negotiate a
settlement of the pending claims substantially consistent with a memorandum of
understanding negotiated among class plaintiffs, all issuer defendants and their
insurers. The settlement would provide, among other things, for a release of the
Company and the Individual Defendants for the conduct alleged in the amended
complaint to be wrongful. The Company would agree to undertake other
responsibilities under the settlement, including agreeing to assign, or not
assert, certain potential claims that we may have against our underwriters. Any
direct financial impact of the proposed settlement is expected to be borne by
our insurers. Any such settlement would be subject to various contingencies,
including approval by the Court overseeing the litigation.

The Company is unable to predict the outcome of this suit and its ultimate
effect, if any, on the Company's financial condition; however, the Company's
defense against this suit has and may continue to result in the expenditure of
significant financial and managerial resources. No amounts have been accrued for
this matter.

TidalWire Acquisition Lawsuit

A purported class action and derivative lawsuit was filed on January 7, 2003 in the Court of Chancery in the State of Delaware against the Company, Robert M. Wadsworth, Frank M. Polestra, John H. Curtis, Lawrence A. Genovesi, John A. Blaeser and Fontaine K. Richardson relating to the acquisition of TidalWire Inc. The plaintiffs in the complaint allege that the Company and the named directors of its Board of Directors breached their fiduciary duties by, among other things, paying an excessive amount in the acquisition of TidalWire and purportedly failing to disclose material facts in

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the Company's Joint Proxy Statement/Information Statement distributed to stockholders for approval of the issuance of shares of the Company's Common Stock in the merger. The plaintiffs sought damages, rescission of the merger and other relief. As of September 30, 2003, no liability was recorded in connection with this litigation. On October 30, 2003, the court approved a settlement of the action negotiated by the parties, and that settlement became final on December 1, 2003. Under the settlement, all claims against us and our individual board members were dismissed with prejudice, and (a) the defendants in the lawsuit paid $600,000 to us, (b) plaintiff's attorney fees of $185,000 were paid out of that $600,000 amount and (c) in the disclosure for our next annual meeting, we will detail certain information concerning relationships among our board members.

ITEM 4.SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended September 30, 2003.

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PART II

ITEM 5.MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a)   Market Information

Network Engines' common stock began trading on the NASDAQ National Market on July 13, 2000 under the symbol "NENG". Prior to that time there had been no market for our common stock. The following table sets forth the high and low closing sales prices per share for our common stock on the NASDAQ National Market for the period indicated:

Fiscal Year Ended September 30:	Fiscal 2003		Fiscal 2002	
	High	Low	High	Low
First Quarter	$ 1.05	$0.92	$ 1.11	$0.58

Second Quarter	1.94	0.98	1.21	0.87
Third Quarter	4.60	1.48	1.35	0.86
Fourth Quarter	7.51	3.72	1.15	0.95

(b) Holders of record

As of December 12, 2003, there were approximately 300 holders of record of our common stock. Because many of such shares are held by brokers and other institutions on behalf of stockholders, the Company is unable to estimate the total number of stockholders represented by these record holders.

(c) Dividends

We have never paid or declared any cash dividends on our common stock. We currently intend to retain any earnings for future growth and, therefore, do not expect to pay cash dividends in the foreseeable future.

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(d) Compensation Plans

The following table provides information about the securities authorized for issuance under the Company's equity compensation plans as of September 30, 2003:

Equity Compensation Plan Information

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights (1) (2)	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (3) (4)
Equity compensation plans approved by security holders	5,149,580$	1.57	6,143,233
Equity compensation plans not approved by security holders	--	--	--
Total	5,149,580$	1.57	6,143,233

(1) This table excludes an aggregate of 389,807 shares of the Company's common stock issuable upon exercise of outstanding options assumed by the Company in connection with its acquisition of TidalWire Inc. The weighted-average exercise price of such assumed options is $0.36 per share.

(2) Includes 4,884,580 shares of the Company's Common Stock issuable under the Company's 1999 Stock Incentive Plan and 265,000 shares of the Company's Common Stock issuable under the Company's 2000 Director Stock Option Plan.

(3) Includes 5,566,162 shares issuable under the Company's 1999 Stock Incentive Plan, 387,071 shares of the Company's Common Stock issuable under the Company's 2000 Employee Stock Purchase Plan and 190,000 shares issuable under the Company's 2000 Director Stock Option Plan. Shares issuable under the Company's 1999 Stock Incentive Plan and the Company's 2000 Director Stock Option Plan may be issued in the form of restricted stock or options to purchase the Company's common stock.

(4) On October 1st of each year commencing on October 1, 2000 through and including October 1, 2008, the number of shares of common stock reserved for issuance pursuant to the Company's 1999 Stock Incentive Plan is automatically increased by the lesser of (a) 4,000,000 shares, (b) 5% of the Company's outstanding stock on such date, or (c) an amount determined by the Company's Board of Directors. Notwithstanding the foregoing, in no event may the aggregate number of shares of common stock issued pursuant to awards granted under the Company's 1999 Stock Incentive Plan exceed 20,047,902 shares. Through September 30, 2003, the Company had been authorized to issue 13,057,273 shares of restricted common stock or options to purchase the Company's common stock. As a result, under the terms of the Company's 1999 Stock Incentive Plan, the Company may be authorized in the future to issue 6,990,629 shares of the restricted common stock or options to purchase the Company's common stock.

(d)   Recent Sales of Unregistered Securities

During the fiscal quarter ended September 30, 2003, we issued a total of 988,451 unregistered shares of our common stock upon the cashless exercise of common stock warrants. These cashless

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exercises were conducted in accordance with the original warrant agreements whereby the warrant-holders received a number of shares of our common stock that was lower than the number underlying their warrants in lieu of paying cash for the exercise price of the warrants. This exchange was calculated through a formula included in the original warrant agreements. We did not receive any proceeds from the issuance of these securities. The exemption claimed for this issuance is Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder. Each of the investors represented, in connection with the exercise of the warrant, that it was an "accredited investor" as defined in Regulation D of the Securities Act. The following table summarizes these issuances:

Date of Issuance	Number of Shares Issued	Entity Issued To	Aggregate Value of Securities Issued (1)
July 2, 2003	134,495	Brooktrout Technology, Inc.	$ 541,880
August 29, 2003	168,168	Ascent Venture Partners LP	$1,025,825
August 29, 2003	672,672	Ascent Venture Partners II LP	$4,103,299
September 10, 2003	13,116	Ernest L. Godshalk	$ 98,501
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Total	988,451		$5,769,505

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(1) The aggregate value of the securities issued is based upon the closing price of Network Engines' common stock on the date of issuance, as reported on the NASDAQ National Market.

(e)   Use of Proceeds

On July 18, 2000, the Company sold 7,475,000 shares of common stock in an initial public offering at a price of $17.00 per share pursuant to a Registration Statement on Form S-1 (the "Registration Statement") (Registration No. 333-34286), which was declared effective by the Securities and Exchange Commission on July 12, 2000. The aggregate proceeds to the Company from the offering were approximately $116.9 million reflecting gross proceeds of $127.0 million net of underwriting fees of approximately $8.9 million and other offering costs of approximately $1.3 million. During the period from the offering through September 30, 2003, the Company used the proceeds from its initial public offering as follows: approximately $60.0 million to fund the operations of the Company, approximately $6.2 million for the purchase of property and equipment, approximately $4.6 million to repurchase the Company's common stock under a stock repurchase plan and approximately $13.2 million for the Company's acquisition of TidalWire Inc.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data are derived from the financial statements of Network Engines. The historical results presented are not necessarily indicative of future results. The consolidated statement of operations data for the years ended September 30, 2001, 2002 and 2003 and the consolidated balance sheet data as of September 30, 2002 and 2003 have been derived from our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended September 30, 1999 and 2000 and the consolidated balance sheet data as of September 30, 1999, 2000 and 2001 are derived from our audited consolidated financial statements not included in this Annual Report on Form 10-K. The selected

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consolidated financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Financial Statements and Supplementary Data" and the related Notes included elsewhere in this Annual Report on Form 10-K.

On November 12, 1999, Network Engines completed a three-for-one split of its common stock, which was effected through a stock dividend. On May 17, 2000, Network Engines completed a 2.5-for-1 split of its common stock, which was effected through a stock dividend. All share and per share data included in the selected financial data have been restated to reflect both of these splits.

On December 27, 2002, we completed our acquisition of TidalWire. As a result, the quarter ended March 31, 2003 was the first quarter that included the TidalWire operations in our consolidated results for an entire quarter. Our financial results for the year ended September 30, 2003 only include TidalWire financial results for the period from December 28, 2002 through September 30, 2003. As such, the presentation of historical financial information and any discussion regarding the comparison of historical financial information to financial information for the year ended September 30, 2003, does not include any financial information for TidalWire prior to December 28, 2002, unless otherwise indicated. Forward-looking statements made regarding our expected future operating results include the expected results of both Network Engines and TidalWire on a combined basis.

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Selected Consolidated Financial Data

(in thousands, except per share data)

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	Year ended September 30,				
	1999	2000	2001	2002	2003
Net revenues	$ 6,031	$ 43,074	$ 13,515	$ 14,534	$81,243
Gross profit (loss)	1,282	16,091	(19,444)	2,058	16,737
Operating expenses	6,529	30,609	55,230	17,775	18,686
Loss from operations	(5,247)	(14,518)	(74,674)	(15,717)	(1,949)
Loss before extraordinary item	(6,144)	(12,481)	(69,523)	(14,125)	(1,385)
Net loss	(5,830)	(12,481)	(69,523)	(14,125)	(1,385)
Net loss attributable to common stockholders	$(6,053)	$(20,584)	$(69,523)	$(14,125)	$(1,385)
Loss per common share before extraordinary item--basic and diluted	$ (1.92)	$ (1.99)	$ (2.03)	$ (0.44)	$ (0.04)
Net loss per common share--basic and diluted	$ (1.83)	$ (1.99)	$ (2.03)	$ (0.44)	$ (0.04)
Weighted average shares outstanding--basic and diluted	3,312	10,344	34,241	32,270	33,142

September 30,